



STANDARD STATEMENT OF WORK FOR FINANCIAL AUDITS OF NON-U.S. ORGANIZATIONS CONTRACTED BY THE RECIPIENT

OBJECTIVES AND GENERAL STATEMENT OF WORK

AUDIT OF USAID RESOURCES

MANAGED BY [NAME OF RECIPIENT]

I. BACKGROUND

On [date], the U.S. Agency for International Development (USAID), mission to [Country] (mission) approved the [program name and number] (program), which provided [amount in U.S. Dollars] in [loan/grant] funds to [name of recipient] (recipient) for [describe in general terms the purposes of the program and the principal line items and amounts budgeted, including cost sharing contributions, direct payments and all related financial information of the program, as applicable].

[If recipient activities are financed by more than one program, include a similar paragraph for each program.]

[Include a brief history of the recipient, its principal purposes and goals, location(s) of activities to be audited, location(s) of accounting records and management.]

[The purpose of including complete data on the recipient and the program(s) involved is to provide the auditor with all necessary information for them to properly estimate their audit fees.]

II. TITLE

Audit of the Fund Accountability Statement (or Audit of Financial Statements, if the audit includes an audit of the general-purpose financial statements) of USAID Resources Managed by [name of recipient] Under Program [program number and name] for the period from [date] to [date]. In the case of close-out audits,¹ the title must specify that it is a close-out audit, as in: Close-out Audit of the USAID Resources Managed by [name of recipient] Under Program [program number and name] for the period from [date] to [date].

¹A close-out audit is an audit for an award that expired during the period audited.

January 23, 2009

III. OBJECTIVES

The objective of this engagement is to conduct a financial audit of the USAID resources managed by the recipient under program [*program number and name*] from [*date*] to [*date*] in accordance with U.S. Government Auditing Standards and the USAID “Guidelines for Financial Audits Contracted by Foreign Recipients (Guidelines).”

The financial audit must include (1) a specific audit of all the recipient’s USAID-funded programs, and (2) an audit of the recipient's general purpose financial statements on an organization-wide basis (balance sheet, income statement, and cash flow statement) if the recipient has been authorized to charge indirect costs, or if the mission specifically requests such an audit.

The fund accountability statement is the basic financial statement to be audited that presents the recipient's revenues, costs incurred, cash balance of funds provided by USAID, and commodities and technical assistance directly procured by USAID for the recipient's use. All currency amounts in the fund accountability statement, cost-sharing schedule, schedule of computation of indirect cost rate, and the report findings, if any, must be stated in U.S. dollars. The auditors must indicate the exchange rate(s) used in the notes to the fund accountability statement. The fund accountability statement must be reconciled to the USAID funds included in the general-purpose financial statements by a note to the financial statements or the fund accountability statement.

A. Audit of USAID Funds

A financial audit of the funds provided by USAID must be performed in accordance with U.S. *Government Auditing Standards* and accordingly include such tests of the accounting records as deemed necessary under the circumstances. The specific objectives of the audit of the USAID funds are to:

- Express an opinion on whether the fund accountability statement for the USAID-funded programs presents fairly, in all material respects, revenues received, costs incurred, and commodities and technical assistance directly procured by USAID for the period audited in conformity with the terms of the agreements and generally accepted accounting principles or other comprehensive basis of accounting (including the cash receipts and disbursements basis and modifications of the cash basis).
- Evaluate and obtain a sufficient understanding of the recipient's internal controls related to the USAID-funded programs, assess control risk, and identify reportable conditions, including material internal control weaknesses. This evaluation must include the internal controls related to required cost-sharing contributions.
- Perform tests to determine whether the recipient complied, in all material respects, with agreement terms (including cost sharing, if applicable) and applicable laws and regulations related to USAID-funded programs. All material instances of noncompliance and all illegal acts that have occurred or are likely to have occurred must be identified. Such tests

April 30, 2004

must include the compliance requirements related to required cost-sharing contributions, if applicable.

- Perform an audit of the indirect cost rate(s) if the recipient has been authorized to charge indirect costs to USAID using provisional rates and USAID has not yet negotiated final rates with the recipient. *[If the recipient does not have a USAID authorized indirect cost rate, this fact must be disclosed in the report.]*
- Determine if the recipient has taken adequate corrective action on prior audit report recommendations.

Auditors must design audit steps and procedures in accordance with U.S. *Government Auditing Standards*, Chapter 4, to provide reasonable assurance of detecting situations or transactions in which fraud or illegal acts have occurred or are likely to have occurred. If such evidence exists, the auditors must immediately contact the USAID Regional Inspector General, (RIG) Pretoria office and must exercise due professional care in pursuing indications of possible fraud and illegal acts so as not to interfere with potential future investigations or legal proceedings.

B. Review of Cost Sharing Schedule

The audit must determine whether cost-sharing contributions were provided and accounted for by the recipient in accordance with the terms of the agreements, if applicable. The audit firm must clearly state whether or not cost-sharing contributions were required by the agreement. The auditors will review the cost-sharing schedule to determine if the schedule is fairly presented in accordance with the basis of accounting use by the recipient to prepare the schedule. The auditors must question all cost-sharing contributions that are either ineligible or unsupported costs. In addition, for audits of agreements that present a cost-sharing budget on an annual basis and for close-out audits of awards that present cost-sharing budgets on a life-of-project basis, the auditors will review the cost-sharing schedule to determine if cost-sharing contributions were provided by the recipient in accordance with the terms of the agreement.

C. Audit of General Purpose Financial Statements

A financial audit of the recipient's general-purpose financial statements on an organization-wide basis must be submitted to USAID together with the audit of USAID funds if the recipient has been authorized to charge indirect costs, or if the mission specifically requests such an audit. The audit must be performed in accordance with generally accepted auditing standards of the American Institute of Certified Public Accountants (AICPA), auditing standards that have been prescribed by the laws of the country or adopted by an association of public accountants in the country, or auditing standards promulgated by the International Organization of Supreme Audit Institutions or International Auditing Practices Committee of the International Federation of Accountants. The objective of this audit is to express an opinion on whether those statements present fairly, in all material respects, the financial position of the recipient at year end, and the results of its operations and cash flow for the year then ended, in conformity with generally accepted accounting principles.

January 23, 2009

IV. AUDIT SCOPE

The auditor must use the following steps as the basis for the audit programs and the review. They are not considered all-inclusive or restrictive in nature and do not constitute relief from exercising professional judgment. The steps must be modified to fit local conditions and specific program design, implementation procedures, and agreement provisions which may vary from program to program. Any limitations in the scope of work must be communicated as soon as possible to the USAID RIG/Pretoria office.

A. Pre-Audit Steps

Following is a list of documents applicable to different USAID programs. The auditor must review the applicable documents considered necessary to perform the audit:

1. The agreement between USAID and the recipient.
2. The subagreements between the recipient and other implementing entities, as applicable.
3. Contracts and subcontracts with third parties, if any.
4. The budgets, implementation letters, and written procedures approved by USAID.
5. USAID Automated Directives System Chapter 636 – “Program Funded Advances”
6. OMB Circular A-122 "Cost Principles for Nonprofit Organizations".
7. OMB Circular A-21 "Cost Principles for Educational Institutions".
8. Federal Acquisition Regulation (FAR), Part 31, Contract Cost Principles and Procedures.
9. USAID Acquisition Regulation (AIDAR), which supplement the FAR.
10. Mandatory Standard Provisions for Non-U.S. Nongovernmental Grantees (USAID Automated Directives System, Series 300).
11. Standard Provisions Annex for Project Loan or Grant Agreements with Foreign Governments (USAID Automated Directives System, Series 200).
12. All program financial and progress reports; and charts of accounts, organizational charts; accounting systems descriptions; procurement policies and procedures; and receipt, warehousing and distribution procedures for materials, as necessary to successfully complete the required work.

April 30, 2004

B. Fund Accountability Statement

The auditor must examine the fund accountability statement² for USAID programs including the budgeted amounts by category and major items; the revenues received from USAID for the period covered by the audit; the costs reported by the recipient as incurred during that period; and the commodities/technical assistance directly procured by USAID for the recipient's use. The fund accountability statement must include all USAID assistance funds identified by each specific program or agreement. The revenues received from USAID, less the costs incurred, after considering any reconciling items, must reconcile with the balance of cash-on-hand and/or in bank accounts. The fund accountability statement must not include cost sharing contributions provided from the recipient's own funds or in-kind. However, a separate cost sharing schedule must be included and reviewed to determine whether cost sharing contributions were provided and accounted for in accordance with the terms of the agreement (see section IV.C. of this statement of work).

The auditors may prepare or assist the recipient in the preparation of the fund accountability statement from the books and records maintained by the recipient, but the recipient must accept the responsibility for the statement's accuracy before the audit commences.

The opinion on the fund accountability statement must be in accordance with SAS No. 62 (AU623). The fund accountability statement must separately identify those revenues and costs applicable to each specific USAID agreement. The audit must evaluate program implementation actions and accomplishments to determine whether specific costs incurred are allowable, allocable, and reasonable under the agreement terms, and to identify areas where fraud and illegal acts have occurred or are likely to have occurred as a result of inadequate internal control. At a minimum, the auditors must:

1. Review direct and indirect costs billed to and reimbursed by USAID and costs incurred but pending reimbursement by USAID, identifying and quantifying any questioned costs. *All* costs that are not supported with adequate documentation or are not in accordance with the agreement terms must be reported as questioned. Questioned costs that are pending reimbursement by USAID must be identified in the notes to the fund accountability statement as not reimbursed by USAID.

Questioned costs must be presented in the fund accountability statement in two separate categories (a) *ineligible costs* that are explicitly questioned because they are unreasonable; prohibited by the agreements or applicable laws and regulations; or not program related; and (b)

² A "fund accountability statement" is a financial statement that presents a USAID recipient's revenues, costs incurred, cash balance of funds (after considering reconciling items), and commodities and technical assistance directly procured by USAID that were provided by USAID agreements. The fund accountability statement must be presented in U.S. dollars and the exchange rate(s) used must be disclosed in a note to the fund accountability statement.

January 23, 2009

unsupported costs that are not supported with adequate documentation or did not have required prior approvals or authorizations. All questioned costs resulting from instances of noncompliance with agreement terms and applicable laws and regulations must be included as findings in the report on compliance. Also, the notes to the fund accountability statement must briefly describe the questioned costs and must be cross-referenced to the corresponding findings in the report on compliance.

2. Review general and program ledgers to determine whether costs incurred were properly recorded. Reconcile direct costs billed to, and reimbursed by, USAID to the program and general ledgers.
3. Review the procedures used to control the funds, including their channeling to contracted financial institutions or other implementing entities. Review the bank accounts and the controls on those bank accounts. Perform positive confirmation of balances, as necessary.
4. Determine whether advances of funds were justified with documentation, including reconciliations of funds advanced, disbursed, and available. The auditors must ensure that all funding received by the recipient from USAID was appropriately recorded in the recipient's accounting records and that those records were periodically reconciled with information provided by USAID.
5. Determine whether program income was added to funds used to further eligible program objectives, to finance the non-federal share of the program, or deducted from program costs, in accordance with USAID regulations, other implementing guidance, or the terms and conditions of the award.
6. Review procurement procedures to determine whether sound commercial practices including competition were used, reasonable prices were obtained, and adequate controls were in place over the qualities and quantities received.
7. Review direct salary charges to determine whether salary rates are reasonable for that position, in accordance with those approved by USAID when USAID approval is required, and supported by appropriate payroll records. Determine if overtime was charged to the program and whether it is allowable under the terms of the agreements. Determine whether allowances and fringe benefits received by employees were in accordance with the agreements and applicable laws and regulations. The auditors must question unallowable salary charges in the fund accountability statement.
8. Review travel and transportation charges to determine whether they are adequately supported and approved. Travel charges that are not supported with adequate documentation or not in accordance with agreements and regulations must be questioned in the fund accountability statement.
9. Review bank charges to determine whether they are adequately supported and reasonable, considering the size of the recipient and the amount of the award under management. Any

April 30, 2004

amounts determined to be unreasonable must be questioned as ineligible in the fund accountability statement.

10. Review commodities (e.g., supplies, materials, vehicles, equipment, food products, tools, etc.) procured by the recipient as well as those directly procured by USAID for the recipient's use. The auditors must determine whether commodities exist or were used for their intended purposes in accordance with the terms of the agreements, and whether control procedures exist and have been placed in operation to adequately safeguard the commodities. As part of the procedures to determine if commodities were used for intended purposes, the auditors must perform end-use reviews for an appropriate sample of all commodities based on the control risk assessment (see section IV.D. of this statement of work). End-use reviews would normally include site visits to verify that commodities exist or were used for their intended purposes in accordance with the terms of the agreements. When conducting end-use reviews, the auditors must ensure that commodities are marked in accordance with grant or contract requirements. The cost of all commodities whose existence or proper use, in accordance with the terms of the agreements, cannot be verified must be questioned in the fund accountability statement.
11. Review technical assistance and services, whether procured by the recipient or directly procured by USAID for the recipient's use. The auditors must determine whether technical assistance and services were used for their intended purposes in accordance with the terms of the agreements. The cost of technical assistance and services not properly used in accordance with the agreements must be questioned in the fund accountability statement.

In addition to the above audit procedures, if technical assistance and services were contracted by the recipient from a non-U.S. contractor, the auditors must perform additional audit steps of the technical assistance and services under this statement of work, unless the recipient has separately contracted for an audit of these costs. When testing for compliance with agreement terms and applicable laws and regulations, the auditors must not only consider the agreements between the recipient and USAID, but also the agreements between the recipient and non-U.S. contractors providing technical assistance and services. The agreements between the recipient and the non-U.S. contractors must be audited using the same audit steps described in the other paragraphs of this section, including all tests necessary to specifically determine that costs incurred are allowable, allocable, reasonable, and supported under the agreement terms.

If technical assistance and services were *not* contracted by the recipient from a non-U.S. contractor, the auditors are still responsible for determining whether technical assistance and services were used for their intended purposes in accordance with the terms of the agreements. However, the auditors are not responsible for performing additional audit steps for the costs incurred under the technical assistance and services agreements, since either USAID or a cognizant U.S. government agency is responsible for contracting for audits of these costs.

12. When indirect costs are charged to USAID using provisional rates, review the allocation method to determine that the indirect cost pool and distribution base include only allowable items in accordance with the agreement terms and regulations. The auditors must be aware that costs

January 23, 2009

that are unallowable as direct charges to USAID agreements (e.g., fundraising) must be allocated their share of indirect costs if they represent activities that (1) include the salaries of personnel, (2) occupy space, and (3) benefit from the organization's indirect costs. Indirect costs must be calculated after all adjustments have been made to the pool and base. *[If the recipient does not have a USAID authorized indirect cost rate, this fact must be disclosed in the report.]*

13. For final closeout audits, review unliquidated advances to the recipient and pending reimbursements by USAID. Ensure that the recipient has returned any excess cash to USAID. Also, ensure that all assets (inventories, fixed assets, commodities, etc.) procured with program funds were disposed of in accordance with the terms of the agreements. The auditors must present, as an annex to the fund accountability statement, the balances and details of final inventories of nonexpendable property acquired under the agreements. This inventory must indicate which items were titled to the U.S. Government and which were titled to other entities. These close out audit procedures must be performed for any award that expires during the period audited.

An illustrative fund accountability statement is included as Example 6.1 of the *Guidelines*. This example illustrates how to report the results of a single audit that covers more than one USAID agreement. In such cases, the fund accountability statement must separately disclose the financial information (revenues, costs, etc.) for each agreement, and must identify the USAID missions that provided funding for each agreement. Questioned costs, and internal control and compliance findings of any audits of subrecipients must be reported in the recipient's financial audit using the same treatment and procedures as the recipient's own questioned costs and findings. This is particularly important in audits of recipients covering grants from more than one USAID mission, so that each mission can identify its grants in the audit report for resolution of findings and recommendations with the recipient. The same reporting principles apply when only one USAID agreement is covered by the audit.

The auditors must generally express a single opinion on the fund accountability statement that includes more than one agreement with USAID. Auditors *must not* express separate opinions on fund accountability statements of each agreement or program unless specifically requested to do so by the USAID mission.

C. Cost-Sharing Schedule

USAID agreements may require cost-sharing contributions by the recipient. Most agreements establish a life-of-project budget for such contributions; however, some agreements may establish annual budgets for those contributions. The review of the cost sharing schedule must be approached differently depending on whether the cost-sharing budget is a life-of project budget or an annual budget. In either case, the review consists principally of inquiries of recipient personnel and analytical procedures applied to financial data supporting the cost-sharing schedule.

The auditors may prepare or assist the recipient in preparing the cost-sharing schedule from the books and records maintained by the recipient. The recipient must, however, accept responsibility for the

April 30, 2004

schedule's accuracy before the review commences.

C (1). Agreement with Life-of-Project Cost-Sharing Budget

For an agreement with a life-of-project budget for cost-sharing contributions, it is not possible to determine whether the contributions have been made as required until the agreement ends. Nonetheless, USAID and the recipient need reliable information to monitor actual cost-sharing contributions throughout the life of the agreement.

Thus, for agreements with a life-of-project budget for cost-sharing contributions, for each year that an audit is performed in accordance with the *Guidelines*, the auditors will review the cost-sharing schedule to determine if the schedule is fairly presented in accordance with the basis of accounting used by the recipient to prepare the schedule. The auditors must question all cost-sharing contributions that are either ineligible or unsupported costs. An ineligible cost is unreasonable, prohibited by the agreements or applicable laws and regulations, or not program related. An unsupported cost lacks adequate documentation or does not have required prior approvals or authorizations. All questioned costs must be briefly described in the notes to the cost-sharing schedule. In addition, questioned costs must be included as findings in the report on compliance. Notes to the cost-sharing schedule must be cross-referenced to the corresponding findings in the report on compliance. Also, reportable internal control weaknesses related to cost-sharing contributions must be set forth as findings in the report on internal control. (See sample cost-sharing schedule at Example 6.2.A, and sample reports at Examples 7.6.A and 7.6.B of the *Guidelines*.)

In addition, for closeout audits of agreements with a life-of-project budget for cost-sharing contributions, the auditors will review the cost-sharing schedule to determine if the recipients provided such contributions in accordance with the terms of the agreement. If actual contributions were less than budgeted contributions, the shortfall will be identified in the appropriate column of the cost-sharing schedule. (See sample cost-sharing schedule at Example 6.2.B, and sample reports at Examples 7.6.C and 7.6.D of the *Guidelines*.)

C (2). Agreement with Annual Cost-Sharing Budget

For agreements with an annual budget for cost-sharing contributions, for each year that an audit is performed in accordance with the *Guidelines*, the auditors will review the cost-sharing schedule to determine whether (1) the schedule is fairly presented in accordance with the basis of accounting used by the recipient to prepare the cost-sharing schedule and (2) contributions were provided by the recipient in accordance with the terms of the agreement. The auditors must question all cost-sharing contributions that are either ineligible or unsupported costs. An ineligible cost is unreasonable, prohibited by the agreements or applicable laws and regulations, or not program related. An unsupported cost lacks adequate documentation or does not have required prior approvals or authorizations. All questioned costs must be briefly described in the notes to the cost-sharing schedule. In addition, questioned costs must be included as findings in the report on compliance. Notes to the cost-sharing schedule must be cross-referenced to the corresponding findings in the report on compliance. Also, reportable internal control weaknesses related to cost-sharing contributions must be

January 23, 2009

set forth as findings in the report on internal control. If actual cost-sharing contributions were less than budgeted contributions, the shortfall will be identified in the appropriate column of the cost-sharing schedule. (See sample cost-sharing schedule at Example 6.2.B, and sample reports at Examples 7.6.C and 7.6.D of the *Guidelines*.)

D. Internal Controls

The auditors must review and evaluate the recipient's internal controls related to USAID programs to obtain a sufficient understanding of the design of relevant control policies and procedures and whether those policies and procedures have been placed in operation. The U.S. General Accounting Office's *Standards for Internal Controls in the Federal Government* (GAO/AIMD-00-21.3.1; 1999) may be helpful in assessing recipient internal controls. The auditor's understanding of the internal controls must be documented in the working papers.

Prepare the report required by the USAID Guidelines, identifying the reportable conditions that are significant deficiencies in the design or operation of the internal controls, and the reportable conditions considered to be material weaknesses. Material weaknesses are reportable conditions in which the design or operation of the specific internal control elements do not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the fund accountability statement may occur and not be detected within a timely period by management performing its normal functions. Reportable conditions, including material weaknesses, must be set forth in the report as "findings" (see paragraph 5.1.d of the *Guidelines*). Reportable conditions involve matters coming to the auditor's attention relating to significant deficiencies in the design or operation of internal controls that, in the auditor's judgment, could adversely affect the recipient's ability to record, process, summarize, and report financial data consistent with the assertions of management in the fund accountability statement and cost-sharing schedule. Nonreportable conditions must be included in a separate management letter to the recipient and referred to in the report on the internal controls.

The major internal control components to be studied and evaluated include, but are not limited to, the controls related to each revenue and expense account on the fund accountability statement. The auditors must:

1. Obtain a sufficient understanding of the internal controls to plan the audit and to determine the nature, timing and extent of tests to be performed.
2. Assess inherent risk and control risk, and determine the combined risk. Inherent risk is the susceptibility of an assertion, such as an account balance, to a material misstatement assuming there are no related internal control policies or procedures. Control risk is the risk that a material misstatement, that could occur in an assertion, will not be prevented or detected on a timely basis by the entity's internal control policies or procedures. Combined risk (sometimes referred to as detection risk) is the risk that the auditor will not detect a material misstatement that exists in an assertion. Combined risk depends upon the effectiveness of an auditing procedure and its application by the auditor.
3. Summarize the risk assessments for each assertion in a working paper. The risk assessments

April 30, 2004

must consider the following broad categories under which each assertion should be classified: (a) existence or occurrence; (b) completeness; (c) rights and obligations; (d) valuation or allocation; and (e) presentation and disclosure. At a minimum, the working papers must identify the name of the account or assertion, the account balance or the amount represented by the assertion, the assessed level of inherent risk (high, moderate, or low), the assessed level of control risk (high, moderate, or low), the combined risk (high, moderate, or low), and a description of the nature, extent, and timing of the tests performed based on the combined risk. These summary working papers must be cross-indexed to the supporting working papers that contain the detailed analysis of the fieldwork. If control risk is evaluated at less than the maximum level (high), then the basis for the auditor's conclusion must be documented in the working papers.

If the control risk is assessed at the maximum level for assertions related to material account balances, transaction classes, and disclosure components of financial statements when such assertions are significantly dependent upon computerized information systems, the auditors must document in the working papers the basis for such conclusions by addressing (i) the ineffectiveness of the design and/or operation of controls, or (ii) the reasons why it would be ineffective to test the controls.

4. Evaluate the control environment, the adequacy of the accounting systems, and control procedures. Emphasis must be placed on the policies and procedures that pertain to the recipient's ability to record, process, summarize, and report financial data consistent with the assertions embodied in each account of the fund accountability statement. This evaluation must include, but not be limited to, the control systems for:
 - a. ensuring that charges to the program are proper and supported;
 - b. managing cash on hand and in bank accounts;
 - c. procuring goods and services;
 - d. managing inventory and receiving functions;
 - e. managing personnel functions such as timekeeping, salaries, and benefits;
 - f. managing and disposing of commodities (such as vehicles, equipment, and tools, as well as other commodities) purchased either by the program or directly by USAID; and
 - g. ensuring compliance with agreement terms and applicable laws and regulations that collectively have a material impact on the fund accountability statement. The results of this evaluation must be contained in the working paper section described in Section IV.E. of this statement of work dealing with the review of compliance with agreement terms and applicable laws and regulations and presented in the compliance report.

January 23, 2009

5. Evaluate internal controls established to ensure compliance with cost-sharing requirements, if applicable, including both provision and management of the contributions.
6. Include in the study and evaluation other policies and procedures that may be relevant if they pertain to data the auditor uses in applying auditing procedures. This may include, for example, policies and procedures that pertain to nonfinancial data that the auditor uses in analytical procedures.

In fulfilling the audit requirement relating to an understanding of the internal controls and assessing the level of control risk, the auditor must follow, at a minimum, the guidance contained in AICPA SAS Nos. 55, 60, 78 and 94 (AU110, AU319, AU324 and AU325), respectively entitled *Consideration of Internal Control in a Financial Statement Audit*, *Communication of Internal Control Related Matters Noted in an Audit*, and *Consideration of Internal Control in a Financial Statement Audit: An Amendment to SAS 55*, and *The effect of Information Technology on the Auditor's Consideration of Internal Control in a Financial Statement Audit*, SAS No. 74 (AU801) entitled *Compliance Auditing Considerations in Audits of Governmental Entities and Recipients of Governmental Financial Assistance*, as well as SAS No. 99 entitled *Consideration of Fraud in a Financial Statement Audit*.

E. Compliance with Agreement Terms and Applicable Laws and Regulations

In fulfilling the audit requirement to determine compliance with agreement terms and applicable laws and regulations related to USAID programs, the auditors must, at a minimum, follow guidance contained in AICPA SAS No. 74 (AU801) entitled *Compliance Auditing Considerations in Audits of Governmental Entities and Recipients of Governmental Financial Assistance*. The compliance review must also determine – on audits of awards that present cost-sharing budgets on an annual basis and on close-out audits of awards that present cost-sharing budgets on a life-of-project basis - if cost-sharing contributions were provided and accounted for in accordance with the terms of the agreements. The auditor's report on compliance must set forth as findings all material instances of noncompliance, defined as instances that could have a direct and material effect on the fund accountability statement. Nonmaterial instances of noncompliance must be included in a separate management letter to the recipient and referred to in the report on compliance.

The auditor's report must include all conclusions that a fraud or illegal act either has occurred or is likely to have occurred. In reporting material fraud, illegal acts, or other noncompliance, the auditors must place their findings in proper perspective. To give the reader a basis for judging the prevalence and consequences of these conditions, the instances identified should be related to the universe or the number of cases examined and be quantified in terms of U.S. dollar value, if appropriate. In presenting material irregularities, illegal acts, or other noncompliance, auditors must follow the reporting standards contained in Chapter 5 of U.S. *Government Auditing Standards*. Auditors may provide less extensive disclosure of irregularities and illegal acts that are not material in either a quantitative or qualitative sense. Chapter 4 of U.S. *Government Auditing Standards* provides guidance on factors that may influence auditors' materiality judgments. If the auditor concludes that sufficient evidence of irregularities or illegal acts exists, they must immediately contact the USAID RIG/Pretoria office and must exercise due professional care in pursuing indications of possible irregularities and illegal acts so as not to interfere with potential future investigations and/or legal proceedings.

April 30, 2004

In planning and conducting the tests of compliance the auditors must:

1. Identify the agreement terms and pertinent laws and regulations and determine which of those, if not observed, could have a direct and material effect on the fund accountability statement. The auditors must:
 - a. list all standard and program-specific provisions contained in the agreements that cumulatively, if not observed, could have a direct and material effect on the fund accountability statement;
 - b. assess the inherent and control risk that material noncompliance could occur for each of the compliance requirements listed in 1.a. above;
 - c. determine the nature, timing and extent of audit steps and procedures to test for errors, fraud, and illegal acts that provide reasonable assurance of detecting both intentional and unintentional instances of noncompliance with agreement terms and applicable laws and regulations that could have a material effect on the fund accountability statement. This must be based on the risk assessment in 1.b. above; and
 - d. prepare a summary working paper that adequately identifies each of the specific compliance requirements included in the review, the results of the inherent, control, and combined (detection) risk assessments for each compliance requirement, the audit steps used to test for compliance with each of the requirements based on the risk assessment, and the results of the compliance testing for each requirement. The summary working paper must be cross-indexed to detailed working papers that adequately support the facts and conclusions contained in the summary working paper.
2. Determine if payments have been made in accordance with agreement terms and applicable laws and regulations.
3. Determine if funds have been expended for purposes not authorized or not in accordance with applicable agreement terms. If so, the auditor must identify these costs as questioned in the fund accountability statement.
4. Identify any costs not considered appropriate, classifying and explaining why these costs are questioned.
5. Determine whether commodities, whether directly procured by the recipient or directly procured by USAID for the recipient's use, exist or were used for their intended purposes in accordance with the agreements. If not, the cost of such commodities must be questioned.
6. Determine whether any technical assistance and services, whether procured by the recipient or directly procured by USAID for the recipient's use, were used for their intended purposes in

January 23, 2009

accordance with the agreements. If not, the cost of such technical assistance and services must be questioned.

7. Determine if the amount of cost sharing funds was calculated and accounted for as required by the agreements or applicable cost principles.
8. Determine if the cost sharing funds were provided according to the terms of the agreements and quantify any shortfalls.
9. Determine whether those who received services and benefits were eligible to receive them.
10. Determine whether the recipient's financial reports (including those on the status of cost sharing contributions) and claims for advances and reimbursement contain information that is supported by the books and records.

F. Follow-Up on Prior Audit Recommendations

The auditors must review the status of actions taken on findings and recommendations reported in prior audits of USAID-funded programs. Chapter 4 of the U.S. *Government Auditing Standards* under the section entitled *Considering the Results of Previous Audits and Attestation Engagements*, states:

"Auditors should consider the results of previous audits and attestation engagements and follow up on known significant findings and recommendations that directly relate to the objectives of the audit being undertaken". As well, the Chapter states, "Auditors should use professional judgment in determining (1) prior periods to be considered, (2) the level of work necessary to follow up on significant findings and recommendations that affect the audit, and (3) the affect on the risk assessment and audit procedures in planning the current audit." They must do this to determine whether the auditee has taken timely and appropriate corrective actions. Auditors must report the status of uncorrected material findings and recommendations from prior audits that affect the financial statement audit."

The auditors must review and report on the status of actions taken on prior findings and recommendations in the summary section of the audit report. The auditors must refer to the most recent recipient or agency contracted audit report for the same award (for a follow-up audit) or other USAID awards (for an initial audit). When corrective action has not been taken and the deficiency remains unresolved for the current audit period and is reported again in the current report, the auditors need to briefly describe the prior finding and status and show the page reference to where it is included in the current report. If there were no prior findings and recommendations, the auditors must include a note to that effect in this section of the audit report.

G. General Purpose Financial Statements

Auditors must examine the recipient's general purpose financial statements on an organization-wide basis if an indirect cost rate needs to be audited,³ or if the mission specifically requests that the

³ Where indirect costs are authorized, an audit of the general purpose financial statements is needed to ensure that all costs have been correctly included in the indirect cost rate calculation.

April 30, 2004

general purpose financial statements be audited. The audit must be performed in accordance with generally accepted auditing standards of the American Institute of Certified Public Accountants (AICPA), auditing standards that have been prescribed by the laws of the country or adopted by an association of public accountants in the country, or auditing standards promulgated by the International Organization of Supreme Audit Institutions or International Auditing Practices Committee of the International Federation of Accountants.

The objective of this audit is to express an opinion on whether those statements present fairly, in all material respects, the recipient's financial position at year-end, and the results of its operations and cash flow for the year then ended, in conformity with generally accepted accounting principles.

H. Indirect Cost Rates

[If the recipient does not have a USAID authorized indirect cost rate, this fact must be disclosed in the report.]

The auditors must determine the actual indirect cost rates for the year if the recipient has used provisional rates to charge indirect costs to USAID. The audit of the indirect cost rates must include tests to determine whether the:

1. distribution or allocation base includes all costs that benefited from indirect activities,
2. distribution or allocation base is in compliance with the governing USAID Negotiated Indirect Cost Rate Agreement (NICRA), if applicable,
3. indirect cost pool includes only costs authorized by the USAID agreements and applicable cost principles,
4. indirect cost rates obtained by dividing the indirect cost pool by the base are accurately calculated, and
5. costs included in this calculation reconcile to the total expenses shown in the recipient's audited general-purpose financial statements.

The results of the audit of the indirect cost rate must be presented in a schedule of computation of indirect cost rate (see Example 6.3 the *Guidelines*). This schedule must contain: (1) a listing of costs included in each indirect cost pool, (2) the distribution base, and (3) the calculation and the resultant indirect cost rate. The costs in the schedule must reconcile to the total expenses shown in the recipient's general purpose financial statements. U.S. Office of Management and Budget (OMB) Circular A-122 provides additional guidance on allocation of indirect costs and determination of indirect cost rates.

I. Other Audit Responsibilities

The auditors must perform the following steps:

January 23, 2009

1. Hold entrance and exit conferences with the recipient. The USAID mission must be notified of these conferences in order that USAID representatives may attend, if deemed necessary.
2. During the planning stages of an audit, communicate information to the auditee regarding the nature and extent of planned testing and reporting on compliance with laws and regulations and internal control over financial reporting. Such communication must state that the auditors do not plan to provide opinions on compliance with laws and regulations and internal control over financial reporting.⁴ Written communication is preferred. Auditors must document the communication in the working papers.
3. Institute quality control procedures to ensure that sufficient competent evidence is obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the financial statements under audit. While auditors may use their standard procedures for ensuring quality control, those procedures must, at a minimum, ensure that:
 - audit reports and supporting working papers are reviewed by an auditor, preferably at the partner level, who was not involved in the audit. This review must be documented in the working papers;
 - all quantities and monetary amounts involving calculations are footed and cross-footed; and
 - all factual statements, numbers, conclusions and monetary amounts are cross-indexed to supporting working papers.
4. Ascertain whether the recipient ensured that audits of its subrecipients were performed to ensure accountability for USAID funds passed through to subrecipients (see paragraph 1.6 of the *Guidelines*). If subrecipient audit requirements were not met, the auditors must disclose this in the auditor's report on the fund accountability statement and consider qualifying their opinion.
5. Obtain a management representation letter in accordance with AICPA SAS No. 85 (AU333) and SAS No. 99 signed by the recipient's management. See Example 4.1 of the *Guidelines* for an illustrative management representation letter.

V. AUDIT REPORTS

The recipient must submit to the USAID Mission [*number*] copies of the report in English and [*number*] copies of the report in the official language of the recipient country [*if deemed necessary by the mission*]. The USAID Mission must submit one hard copy and one electronic copy of the report in English to RIG/Pretoria. To make it easier for audit firms to comply with the *Guidelines*, the format and content of the audit reports must follow the illustrative reports in Chapter 7 of the *Guidelines*. The

⁴ The auditors only express an opinion on the fund accountability statement, and the indirect cost rate and general purpose financial statements, if applicable, as indicated on Chapter 3 of these *Guidelines*.

April 30, 2004

audit report must specify the correct award number(s) of each award covered by the audit. The report must contain:

- A. a title page,⁵ table of contents and a transmittal letter and summary which includes: (1) a background section with a general description of the USAID programs audited, the period covered, the program objectives, a clear identification of all entities mentioned in the report, a section on the follow-up of prior audit recommendations, and whether the recipient has a USAID-authorized provisional indirect cost rate; (2) the objectives and scope of the financial audit, and a clear explanation of the procedures performed and the scope limitations, if any; (3) a brief summary of the audit results on the fund accountability statement, questioned costs, internal controls, compliance with agreement terms and applicable laws and regulations, indirect cost rates, status of prior audit recommendations, and, if applicable, the recipient's general purpose financial statements on an organization-wide basis; (4) a brief summary of the results of the review of cost-sharing contributions; and (5) a brief summary of the recipient's management comments regarding their views on the audit results and findings.
- B. the auditor's report on the fund accountability statement, identifying any questioned costs not fully supported with adequate records or not eligible under the terms of the agreement. The report must be in conformance with the standards for reporting in Chapter 5 of the *U.S. Government Auditing Standards* and must include:
 - 1. The auditor's opinion on whether the fund accountability statement presents fairly, in all material respects, program revenues, costs incurred, and commodities and technical assistance directly procured by USAID for the year then ended in accordance with the terms of the agreements and in conformity with generally accepted accounting principles or other basis of accounting. This opinion must clearly state that the audit was performed in accordance with U.S. *Government Auditing Standards* or specific alternative standards if applicable (see paragraph 2.9.d of the *Guidelines*). Any deviations from these standards, such as noncompliance with the requirements for continuing professional education and external quality control reviews, must be disclosed (See Example 7.1.A of the *Guidelines*).
 - 2. The fund accountability statement identifying the program revenues, costs incurred, and commodities and technical assistance directly procured by USAID for the fiscal year. The statement must also identify questioned costs not considered eligible for reimbursement and unsupported, if any, including the cost of any commodities and technical assistance directly procured by USAID whose existence or proper use in accordance with agreements could not be verified. All questioned costs resulting from instances of noncompliance with agreement terms and applicable laws and regulations must be included as findings in the report on compliance. Also, the notes to the fund

⁵ "Closeout audits must specify they are closeout audits on the title page. A closeout audit is an audit for an award that expired during the period audited.

accountability statement must briefly describe all questioned costs and must be cross-referenced to any corresponding findings in the report on compliance (see Example 6.1 of the *Guidelines*). All questioned costs in the notes to the fund accountability statement must be stated in U.S. dollars. The U.S. dollar equivalent must be calculated at the exchange rate applicable at the time the local currency was disbursed to the recipient by USAID.

3. Notes to the fund accountability statement, including a summary of the significant accounting policies, explanation of the most important items of the statements, the exchange rates during the audit period and foreign currency restrictions, if any. In addition, a note to the fund accountability statement must state whether any interest on USAID funds was returned to USAID.
- C. a report on the auditor's review of the schedule of cost-sharing contributions. The report must follow the guidance in the AICPA Statements on Standards for Attestation Engagements, Attestation Standard (AT) for review reports AT100.64. The report must include:
1. A review report on the cost-sharing schedule. This review report must state that the review was conducted in accordance with AICPA standards. It must also explain that a review is more limited in scope than an examination performed in accordance with AICPA standards, and state that an opinion on the schedule is not expressed. The report must identify questioned costs related to the provision of, and accounting for, cost-sharing contributions, with a reference to the corresponding finding in the report on compliance. The report must provide negative assurance with regard to the provision of, and accounting for, cost-sharing contributions for items not tested (see Examples 7.6.A through 7.6.D of the *Guidelines*).
 2. The cost sharing schedule identifying questioned costs (see Examples 6.2.A and 6.2.B or the *Guidelines*). Cost-sharing contributions that are unreasonable, prohibited by the agreements or applicable laws and regulations, or not program related are ineligible. Cost-sharing contributions that lack adequate documentation or do not have required prior approvals or authorizations are unsupported.
 3. The cost-sharing schedule identifying the budgeted amounts required by the agreements,⁶ the amounts actually provided, and any cost-sharing shortfalls (see Example 6.2.B of the *Guidelines*).
 4. Notes to the cost sharing schedule that briefly explain the basis for questioned costs and shortfalls, if applicable. The notes must be cross-referenced to the corresponding findings in the report on compliance.

⁶ This step is required for audits of agreements that present cost-sharing budgets on an annual basis and for closeout audits of awards that present cost-sharing budgets on a life-of-project basis. See paragraphs 4.12 and 4.13 of the *Guidelines*.

April 30, 2004

- D. the auditor's report on internal control. The auditor's report must include as a minimum: (1) the scope of the auditor's work in obtaining an understanding of the internal controls and in assessing the control risk, and; (2) the reportable conditions, including the identification of material weaknesses recipient's internal controls. Reportable conditions must be described in a separate section (see paragraphs 5.2 through 5.4 of the *Guidelines*). This report must be made in conformance with SAS No. 60 and the standards for reporting in Chapter 5 of U.S. *Government Auditing Standards*. Nonreportable conditions must be communicated to the recipient in a separate management letter which must be referred to in the report on internal controls and sent with the audit report (see Examples 7.2.A and 7.2.B of the *Guidelines*).
- E. the auditor's report on the recipient's compliance with agreement terms and applicable laws and regulations related to USAID-funded programs. The report must follow the guidance in SAS No. 74. Material instances of noncompliance must be described in a separate section (see paragraphs 5.2 through 5.4 of the *Guidelines*). Nonmaterial instances of noncompliance must be communicated to the recipient in a separate management letter, which must be sent with the audit report (see Examples 7.3.A and 7.3.B of the *Guidelines*). All questioned costs resulting from instances of noncompliance must be included as findings in the report on compliance. Also, the notes to the fund accountability statement that describe questioned costs must be cross-referenced to any corresponding findings in the report on compliance.

The auditor's report must include all conclusions, based on evidence obtained, that a fraud or illegal act either has occurred or is likely to have occurred. This report must include an identification of all questioned costs, if any, as a result of fraud or illegal acts, without regard to whether the conditions giving rise to the questioned costs have been corrected and whether the recipient does or does not agree with the findings and questioned costs.

In reporting material fraud, illegal acts, or other noncompliance, the auditors must place their findings in proper perspective. To give the reader a basis for judging the prevalence and consequences of these conditions, the instances identified must be related to the universe or the number of cases examined and is quantified in terms of U.S. dollar value, if appropriate. In presenting material fraud, illegal acts, or other noncompliance, auditors must follow the reporting standards contained in Chapter 5 of U.S. *Government Auditing Standards*. Auditors may provide less extensive disclosure of irregularities and illegal acts that are not material in either a quantitative or qualitative sense. Chapter 4 of U.S. *Government Auditing Standards* provides guidance concerning factors that may influence auditors' materiality judgments. If the auditors conclude that sufficient evidence of irregularities or illegal acts exist, they must contact the USAID RIG/Pretoria office and exercise due professional care in pursuing indications of possible irregularities and illegal acts so as not to interfere with potential future investigations and/or legal proceedings.

- F. the schedule of computation of indirect cost rate (see Example 6.3 of the *Guidelines*) and the auditor's report on the schedule of computation of indirect cost rate. This must be a separate report prepared in accordance with guidance set forth in SAS No. 29. (AU551), (see Example 7.4 of the *Guidelines*). *[This schedule and report are not required if the recipient does not have*

January 23, 2009

a USAID authorized indirect cost rate.]

- G.** the recipient's general-purpose financial statements on an organization-wide basis and the auditor's report on them. These statements and the report on them only apply to recipients with an indirect cost rate that needs to be audited, unless the mission specifically requests that the statements be audited.
- H.** the auditor's comments on the status of prior audit recommendations. The auditors must review and report on the status of actions taken on findings and recommendations reported in prior audits. When corrective action has not been taken and the deficiency remains unresolved for the current audit period and is reported again in the current report, the auditors need only briefly describe the prior finding and show the page reference where it is included in the current report. If there were no prior findings and recommendations, a note to that effect must be included in this section of the audit report.

The findings contained in the reports on internal controls and compliance related to USAID-funded programs must include a description of the condition (what is) and the criteria (what should be). The cause (why it happened) and effect (what harm was caused by not complying with the criteria) must be included in the findings. In addition, the findings must contain a *recommendation* that corrects the cause and the condition, as applicable. It is recognized that material internal control weaknesses and noncompliance found by the auditors may not always have all of these elements fully developed, given the scope and objectives of the specific audit. The auditors must, however, at least identify the condition, criteria and possible effect to enable management to determine the cause and take timely and proper corrective action.

Findings which involve monetary effect must:

1. Be quantified and included as questioned costs in the fund accountability statement, the Auditor's Report on Compliance, and cost-sharing schedule (cross-referenced).
2. Be reported without regard to whether the conditions giving rise to them were corrected.
3. Be reported whether the recipient does or does not agree with the findings or questioned costs.
4. Contain enough relevant information to expedite the audit resolution process (e.g., number of items tested, size of the universe, error rate, corresponding U.S. dollar amounts, etc.).

The reports must also contain, after each recommendation, pertinent views of responsible recipient officials concerning the auditor's findings and actions taken by the recipient to implement the recommendations. If possible, the auditor should obtain written comments. When the auditors disagree with management comments opposing the findings, conclusions, or recommendations, they should explain their reasons following the comments. Conversely, the auditors should modify their report if they find the comments valid.

April 30, 2004

Any evidence of fraud or illegal acts that have occurred, or are likely to have occurred, must be included in a separate written report if deemed necessary by USAID RIG/Pretoria. This report must include an identification of all questioned costs as a result of irregularities or illegal acts, without regard to whether the conditions giving rise to the questioned costs have been corrected or whether the recipient does or does not agree with the findings and questioned costs.

VI. INSPECTION AND ACCEPTANCE OF AUDIT WORK AND THE REPORT

USAID RIG/Pretoria is responsible for assuring that the work performed under this statement of work complies with U.S. *Government Auditing Standards* and the "Guidelines for Financial Audits Contracted by Foreign Recipients." To accomplish this objective, USAID RIG/Pretoria will perform desk reviews on every draft audit report and will perform quality control reviews of the working papers of a sample of final audit reports received from the independent auditors.

For quality control reviews, the audit firm must ensure that all audit records related to USAID agreements are available to enable RIG/Pretoria auditors to complete and support their review. To this end, the RIG/Pretoria auditors must have access to all pertinent working papers and records of the recipient and their subrecipients and make excerpts, photocopies, and transcripts.

If RIG/Pretoria rejects the work of an audit firm due to noncompliance with the *Guidelines*, the audit costs may not be charged to the USAID agreements until RIG/Pretoria finds the report to be acceptable.

USAID must withhold final payment for any work determines to be substandard until acceptable corrective action is taken. Should the audit firm fail to make its report acceptable, either a different recipient-contracted audit firm or RIG/Pretoria may perform another audit. In such case, the audit firm will not be considered acceptable to perform future audits until RIG/Pretoria determines that it has undergone an external quality control review, implemented the resultant recommendations, and is capable of substantially improved performance.

VII. RELATIONSHIPS AND RESPONSIBILITIES

The client for this contract is the recipient. The USAID RIG/Pretoria is responsible for responding to inquiries on audit matters during the audit. RIG/Pretoria also monitors the quality of such audits as mentioned in the Section VI above. The Program Coordinator for the RIG/Pretoria office is Matthew Rathgeber, Audit Manager, or his designee.

Recipients must ensure that all records are available to the independent auditors, all accounting entries and adjustments are made, and all other necessary steps are taken to enable the auditors to complete their work.

USAID Missions ensure that audit agreements between recipients and independent auditors contain a standard statement of work containing all the requirements of the U.S. Government Auditing Standards and the *Guidelines*. Accordingly, recipients must send all prospective audit contracts to the cognizant

January 23, 2009

USAID mission for approval **prior to finalization**. The USAID mission may meet with the public accounting firm at the beginning of the audit to explain any financial/compliance areas of concern that they want emphasized. The USAID mission may also attend the exit conference. The USAID mission should provide the following information to the auditors for the entrance conference:

1. A list of all payments made for assets, equipment, materials, and technical assistance purchased by USAID from third parties for the period being audited with copies of vouchers with supporting documentation.
2. A list of all advances and reimbursements made during the audit period.
3. A list of all disbursements made to the recipient.
4. A copy of the “USAID Mission Checklist for Financial Audit Reports of Non-U.S. Organizations” that the auditors can use to evaluate their audit report.

USAID missions monitor and ensure the audit firm’s submission of required recipient-contracted audit reports.

It is the responsibility of the recipient-contracted audit firm to perform audits pursuant to the *Guidelines* and to present audit reports in a timely manner. The public accounting firm must properly maintain and store the working papers for a period of three years from the completion of the audit. During this three-year period the audit firm shall immediately provide the working papers when requested by the USAID mission or RIG/Pretoria and allow them full access and copies of their working papers. Public accounting firms that are nonresponsive or do not provide timely responses to questions raised by the USAID mission or USAID RIG/Pretoria office shall be temporarily or permanently excluded from performing additional audits.

VIII. TERMS OF PERFORMANCE

The effective date of this contract and statement of work will be the date of the recipient Contracting Officer's signature.

The audit should begin as soon as possible after the signing of the audit contract. Recipients must submit final audit reports to the cognizant USAID mission, who will forward final reports to the USAID RIG/Pretoria office for review and release. USAID RIG/Pretoria must receive the audit report within nine months after the end of the fiscal year in which the expenditures were incurred. To this end, interim audit work is likely to be needed except in the case of recipients with few transactions. This practice makes timely audit reporting possible, does not restrict the scope of certain audit procedures and should result in reduced audit costs.

Payment will be as follows: 20 percent on the date of this contract, 40 percent on the date the recipient receives the final report and 40 percent on the date RIG/Pretoria approves and issues the final report. *[Payment terms could differ. However, a significant percentage of the payment should be retained until*

April 30, 2004

RIG/Pretoria approves the final report].

January 23, 2009